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AUDIT COMMITTEE AND AUDITOR OVERSIGHT UPDATE

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Summary

PCAOB Isn't Happy with EQR and Has Questions for Audit Committees to Ask. The PCAOB has issued [Spotlight: Inspection Observations Related to Engagement Quality Reviews](#), a staff report on engagement quality review (EQR). An EQR is an evaluation by a competent individual not otherwise involved in the audit of significant judgments made by the engagement team. The PCAOB's standards require an EQR, including the EQR reviewer's concurring approval of issuance of the engagement report, in public company audits and certain other engagements performed under PCAOB standards. The staff report states that 42 percent of the audit firms that the PCAOB inspected in 2022 received a quality control criticism related to EQR and that three of the six large U.S. global network firms had at least one EQR deficiency. In a statement, PCAOB Chair Williams urged audit committees to read the staff EQR report "so they can fully live up to their responsibility to protect investors against insufficiently supported audits." The report includes suggested questions concerning the EQR process and its results that audit committees may want to raise with their auditor. ([more](#))

CAQ Reports on Ten Years of Increasing Audit Committee Transparency. The Center for Audit Quality and research firm Ideagen Audit Analytics have released [2023 Audit Committee Transparency Barometer](#), the tenth edition of their annual assessment of S&P Composite 1500 proxy statement disclosures concerning the work of the audit committee. According to the accompanying [press release](#), audit committees "continue the trend of increasing disclosures in key areas of traditional financial oversight, as well as in emerging areas of responsibility" although "room for improvement remains." In 2023, the three most common audit committee disclosures were how non-audit services may impact auditor independence, the length of time the auditor has been engaged, and that the audit committee is responsible for cybersecurity risk oversight. The topics as to which the CAQ and AA believe disclosure should be improved include how the audit committee considers the tenure of the external auditor, how the audit committee is involved in selecting the engagement partner, and the audit committee's view of the appropriateness of the audit fee. The [Barometer](#) report makes a strong case for greater audit committee transparency, and audit committees should consider expanding their disclosures in the areas it flags for improvement. ([more](#))

After a SPAC-Driven Surge, Restatements Are Returning to "Normal". Ideagen Audit Analytics has released its annual report on public company restatements, [Financial Restatements: A 20-Year Review 2003-2022](#). AA found that SEC filers disclosed 454 restatements in 2022, down 69 percent from 1,467 restatements in 2021. 2022 restatements were filed by 421 companies (5.1 percent of SEC registrants), compared to 1,040 companies (12.8 percent of registrants) that

restated in 2021. Restatement frequency in 2022 was roughly similar to 2020 and 2019 when 4.9 percent and 5.7 percent of companies restated, respectively. 2021 was an outlier because of the large number of restatements filed that year by special purpose acquisition companies.

AA also reports that there were 190 domestic filer reissuance or “Big R” restatements (44 percent of the total) in 2022. Ignoring 2021, the share of restatements that were by reissuance (rather than revision) was higher in 2022 than in any year since 2011. This seems to suggest that companies are taking seriously a warning issued by SEC Chief Accountant Paul Munter that companies and their advisors should not take an unduly narrow view of materiality and that many errors that were treated as immaterial should have triggered a reissuance restatement. Audit committees confronted with errors in prior financial reporting and questions concerning the need to restate should make sure they fully understand the reasons for management’s proposed choice between a reissuance or revision restatement. ([more](#))

[SEC Enforcement Targets Individuals but Rewards Company Cooperation.](#) Two recent reports on the fiscal year 2022 activities of the SEC’s Division of Enforcement paint a picture of an active and aggressive enforcement program that is focused – along with other priorities -- on public company disclosure and on the culpability of individuals for corporate violations. On November 14, the SEC issued a detailed [press release](#) announcing the 2023 results of its enforcement program. During FY 2023 (ended September 30, 2023), the SEC filed 784 enforcement actions, a 3 percent increase over the prior year. Monetary payments ordered in SEC actions (*i.e.*, civil penalties, disgorgement, and pre-judgment interest) totaled \$4.949 billion, the second-highest annual amount in SEC history, but down from the record-setting \$6.439 billion in fiscal year 2022. Approximately two-thirds of the Commission’s cases involved charges against one or more individuals, and it obtained 133 orders barring individuals from serving as officers or directors of public companies, the highest number of such bars in the last 10 years.

On November 15, Cornerstone Research and the New York University Pollack Center for Law & Business released [SEC Enforcement Activity: Public Companies and Subsidiaries—Fiscal Year 2023 Update](#), their annual report on SEC enforcement actions against public companies and their subsidiaries. The Cornerstone/Pollack Center report finds that the SEC filed 91 enforcement actions against public companies and their subsidiaries in fiscal 2023 – a 34 percent increase over 2022. As in prior years, “Issuer Reporting and Disclosure” was the most common category of allegation against public companies. However, despite the increase in cases, monetary settlements in public company and subsidiary actions decreased 50 percent, to \$1.3 billion, the lowest total in the last eight fiscal years. The decrease in penalties appears in part to be the result of increased public company cooperation with the Commission. The SEC noted cooperation in its investigation by 69 percent of public companies that settled in fiscal 2023, and 13 percent of defendants/respondents that cooperated were able to settle without a monetary penalty, more than triple the no-penalty rate from 2014 to 2022.

Audit committees should keep the increasing risk of SEC enforcement action in mind, especially when confronted with accounting “close calls” or management efforts to omit or downplay unfavorable information. For companies embroiled in an SEC investigation, the Commission’s track record of rewarding cooperation should be a consideration in deciding how to respond. ([more](#))

[G&AI: Nine Out of Ten Russell 1000 Companies Published a Sustainability Report in 2022.](#) Ninety percent of Russell 1000 companies published a sustainability report in 2022, an increase from 81 percent in 2021 and 70 percent in 2020. That is the headline finding of the Governance & Accountability Institute’s 12th annual edition of its series tracking sustainability reporting trends, [2023 Sustainability Reporting in Focus](#). Companies in the largest half by market cap of the Russell 1000 are nearly all sustainability reporters – 98 percent published a report in 2022, up from 96 percent in 2021 (and 92 percent in 2020). The smallest half of the Russell 1000 had the largest

increase in reporting, jumping to 82 percent publishing a report in 2022, compared to 68 percent in 2021 and 49 percent in 2020. The Sustainability Accounting Standards Board's disclosure standards issued were the most-widely used sustainability disclosure framework among the Russell 1000. Seventy-eight percent of Russell 1000 reporters utilized SASB standards in 2022, an eleven-point increase from last year. As sustainability reporting becomes the norm, audit committees should focus on what ESG disclosures their company makes, how the information is collected, and the controls and procedures to which sustainability disclosures are subject. ([more](#))

[Audit Committees Should Pay Attention to the Statement of Cash Flows.](#) In [The Statement of Cash Flows: Improving the Quality of Cash Flow Information Provided to Investors](#), SEC Chief Accountant Paul Munter reminds companies of the importance of the statement of cash flows. According to Mr. Munter, the “statement of cash flows is integral to a complete set of financial statements, and it should therefore be subject to the same level of due professional care, effective internal controls, and robust, high-quality audit as other financial statements.” His statement urges companies to carefully consider how to best present cash and noncash information and to include additional disclosures that facilitate investor understanding of the statement of cash flows and of the financial statements as a whole. In that regard, he highlights the audit committee's responsibilities: “We encourage audit committees, as part of their important oversight role, to discuss with management and the independent auditor the potential use of the direct method or additional disclosures of gross cash receipts and payments, with an emphasis on investor needs. We also note that independent auditors can use their communications with the audit committee around alternative accounting treatments to facilitate this dialogue.” ([more](#))

[PCAOB Updates its Agendas and Adds a CAMS Review.](#) The PCAOB has [announced](#) updated [standard-setting, research, and rulemaking projects](#) agendas. From an audit committee perspective, the most significant change from the prior listings is that the Board has added a project entitled “Communication of Critical Audit Matters” to its research agenda. This project “seeks to understand why there continues to be a decrease in the average number of critical audit matters reported in the auditor's report over time and whether there is a need for guidance, changes to PCAOB standards, or other regulatory action to improve such reporting, including the information that is provided as part of the CAM reporting.” Other matters on the PCAOB's 2024 agenda that could have a significant impact on the relationship between audit committees and auditors include the proposal to expand the auditor's consideration of possible noncompliance with laws and regulations (NOCLAR), proposed amendments to “modernize and clarify” the standards governing the general responsibilities of the auditor in conducting an audit, and a project to develop firm and engagement performance metrics that could serve as indicators of audit quality and effectiveness. ([more](#))

[FERF: Audit Fees Rose 4.6 Percent in 2022.](#) The Financial Executives Research Foundation, the research affiliate of Financial Executives International, has released [14th Annual Public Company Audit Fee Report](#), its annual survey of audit fees. According to FEI's [press release](#) discussing the report, FERF found that average audit fees increased 4.6 percent from 2021 to 2022. FERF also found that 47 percent of company respondents reported an increase over 2021 in management effort to support the external audit and that 43 percent of preparers expect their finance and accounting teams to spend 50 percent or more of their time on-site supporting the financial statement audit during peak times. Audit committees may want to consider whether changes in their audit fee, or in management effort to support the audit, parallel those of similar companies and the reasons for any differences. ([more](#))

[California Weighs in on Net Zero Disclosure.](#) A new California law will require many companies that make claims regarding the achievement of net zero emissions or that a product is “carbon neutral” to make disclosures concerning the basis for their claims. Under [AB 1305, Voluntary Carbon Market Disclosures](#), entities that make such claims must disclose on a website “information documenting how, if at all, a ‘carbon neutral,’ ‘net zero emission,’ or other similar claim was

determined to be accurate or actually accomplished, and how interim progress toward that goal is being measured.” While AB 1305 applies only to companies that make disclosure or operate in California, the law does not define the meaning of “in California” for these purposes, and the scope of AB 1305 is potentially quite broad. Companies should not make public statements regarding a commitment to carbon neutrality lightly and without a tangible plan to achieve the promised goal. ([more](#))

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The Update's website is www.auditupdate.com.

Updates Nos. 60-75 (June 2020 to July 2022) are available [here](#). Updates Nos. 49-59 (January 2019 to May 2020) are available [here](#). Updates prior to No. 49 are available on request.

An index to titles and topics in the Update beginning with No. 39 (July 2017) is available [here](#).